

Cash Report Fiscal Year 2018



**City Controller
Rebecca Rhynhart**

EDITORIAL AND ADVERTISING USE APPROVED

Introduction

Sufficient cash levels are essential for performing the day-to-day operations of a city government. A city's cash, primarily generated from taxes and fees, is used to pay its employees, vendors, and other obligations, such as debt. Cash levels also provide a measure of a city's ability to pay off short-term obligations, an important indicator of a city's financial strength. As part of our commitment to transparency, the Controller's Office will release information on Philadelphia's cash position each quarter so that taxpayers – residents and businesses – have a fuller picture of the City of Philadelphia's (City) financial health.

The City groups its finances into several different funds to better facilitate control over resources dedicated for specific purposes. For its day-to-day operations, the City pools together the cash balances associated with several funds into a single account, known as the Consolidated Cash account. Three major funds, listed below, and several smaller funds, including the Housing Trust and Hospital Assessment Funds, contribute to the Consolidated Cash account:

- the General Fund, which is the principal operating fund of the City. About three-quarters of the revenue flowing into the General Fund is generated from local taxes;
- the Grants Fund, which manages grants received from state, federal, and private agencies. The Department of Human Services, which provides child welfare services, comprises about 40% of the Grants Fund's spending obligations, with the majority of this spending reimbursed through state funding; and
- the Capital Fund, which manages resources for investing in facilities and infrastructure throughout the city. The majority of its revenue arises from bond proceeds.

The City is legally restricted from utilizing several other funds for its daily operations. These include the Behavioral Health Fund, which handles state funding for behavioral health care services, and the Water and Aviation Funds, which generate self-sustaining revenue through user fees.

Throughout each fiscal year, the City releases a summary of its current financial state, entitled the Quarterly City Manager's Report (QCMR). The report provides an update on the City's financial status compared with the budget outlined prior to the start of each fiscal year. As part of the QCMR, the City publishes actual and projected monthly cash balances for its major operating funds, as well as revenues and expenditures for its principal operating fund, the General Fund. The QCMR offers the most up-to-date snapshot of the current cash position of the City and the most accurate projection for cash balances at the close of the fiscal year.

Within 45-days of the close of each fiscal quarter, the City releases the QCMR. Following its release, the Controller's Office will, in the spirit of financial transparency, use the information presented in the QCMR to publish a Cash Report. Each Cash Report will present updated cash

balances in an interactive format, along with an analysis of prominent trends. The Cash Report for the fourth quarter of each fiscal year will follow a different format, focusing on the City's cash position for the fiscal year as compared to historical data. Again, the Cash Report will present data pulled directly from the City's QCMR.

The following report, the first installment in the Cash Report series, focuses on the City's cash position at the end of the fourth quarter of fiscal year 2018 (FY18), as of June 30, 2018. It considers the cash balances for the entirety of FY18 as compared with historical data dating back to fiscal year 2007.¹

Rating agencies, such as Standard & Poor's (S&P), set guidelines for what is deemed an adequate, good, and strong level of reserves for municipalities. S&P considers fund balance levels that are 8% to 15% of annual expenditures to be strong, while 4% to 8% is considered good. The Government Finance Officers Association recommends governments, regardless of size, maintain a fund balance of no less than two months of General Fund expenditures, corresponding to about 17% of annual expenditures. These recommendations can be used as a measure of how much cash a city should have in reserve.

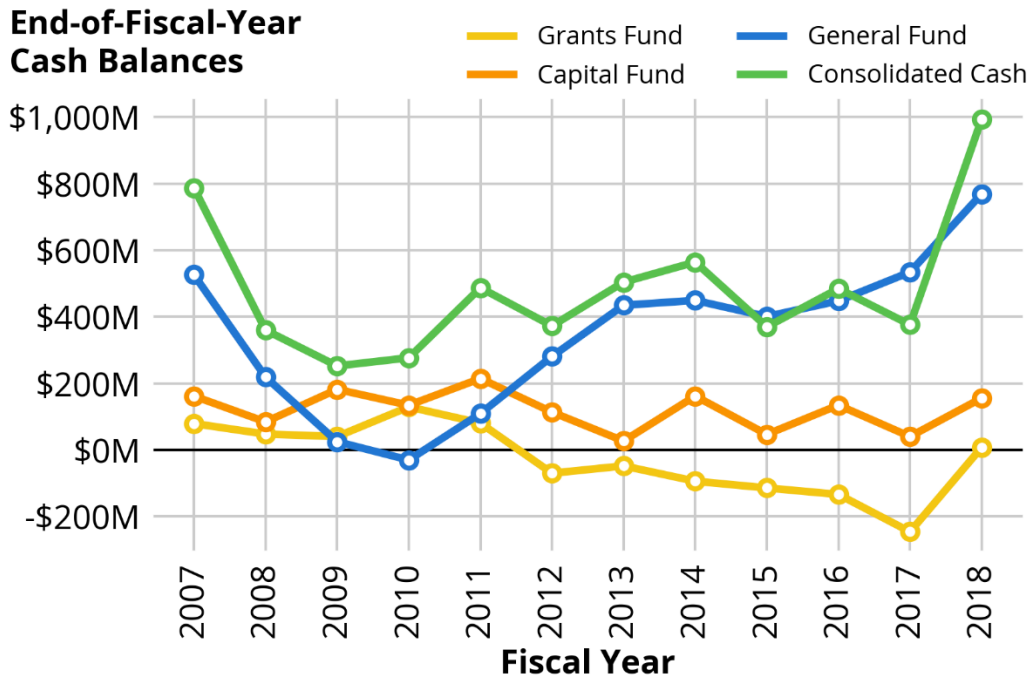
However, it is important to note that these guidelines are set for an unrestricted fund balance reported on a modified accrual basis, which accounts for future, but known, revenues and expenditures. Fund balances on a modified accrual basis are typically lower than balances on a cash basis. For example, in fiscal year 2017 the City's General Fund balance on a modified accrual basis was \$189 million, or 4.6% of expenditures. On a cash basis, the General Fund balance was \$534 million, or 13.1% of expenditures. For consistency, this report focuses on cash levels as detailed in the QCMR.²

Historically, the City has struggled to meet recommendations for fund balance levels. However, FY18 was a good year for the City's cash. The City saw substantial gains to its cash balances. It marks the first time in more than a decade that the General, Grants, and Capital Funds each experienced increases in their end-of-fiscal year cash balances. The result is a historically strong cash position with a General Fund cash balance of \$769 million and a Consolidated Cash balance of \$993 million. The General Fund cash balance of \$769 million represents 18%, or a little over two months-worth, of annual cash expenditures.

¹ Historical data is not corrected for the effects of inflation and is presented as published in the QCMR.

² The FY18 closing fund balance for the General Fund (on a modified accrual basis) is not yet final.

End-of-Fiscal-Year Cash Balances, 2007 – 2018

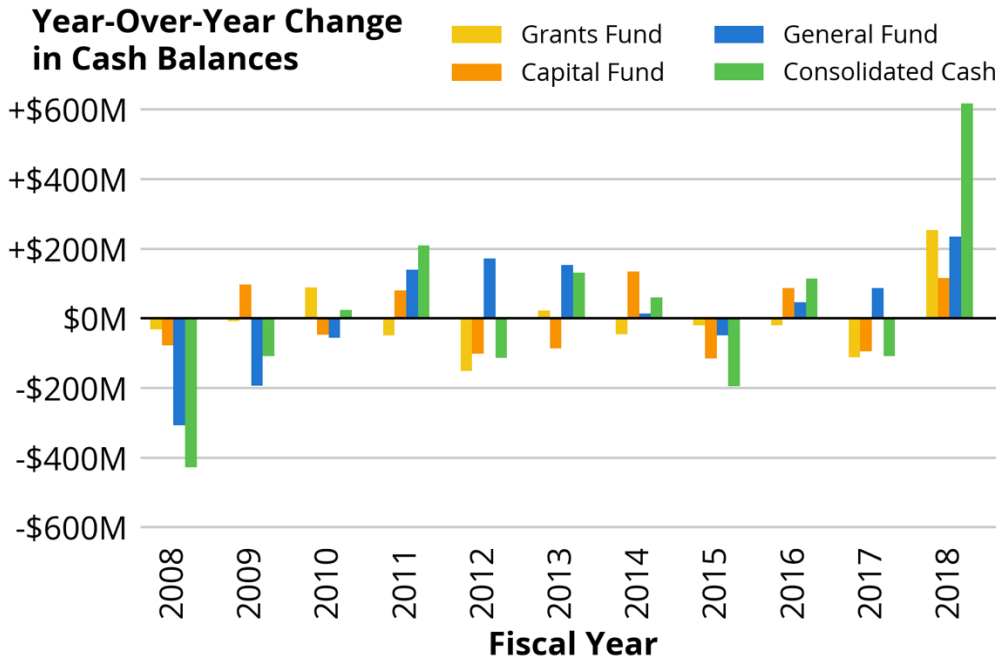


The above chart shows the fiscal year-end cash balances from 2007 to 2018 for the General Fund (blue), Capital Fund (orange), and Grants Fund (yellow). The combined total of these funds, plus a few smaller funds as mentioned previously, is shown as the Consolidated Cash account (green). FY18 was a noteworthy year for the Consolidated Cash account, having both the largest single-year increase and the highest end-of-year balance since 2007. With a closing balance of \$993 million, the Consolidated Cash account has surpassed its pre-Great Recession balance of \$787 million in 2007.

As the primary component of the Consolidated Cash account, the General Fund balance closely tracks the Consolidated Cash balance from year to year. The General Fund, with the majority of its revenue generated through local taxes, is more sensitive to the economic climate than either the Grants or Capital Funds. The General Fund cash balance reached its low point in the years following the Great Recession, with an end-of-year deficit of \$31 million in 2010. From that low point, the General Fund cash balance has climbed slowly to its FY18 closing balance of \$769 million from a combination of economic growth and tax rate increases.

Unlike the General Fund, the Capital Fund is comprised mostly of long-term debt (bond proceeds) usually issued on a two-year cycle. This funding process results in the Capital Fund cash balance decreasing over the course of several years from about \$200 million to about \$0 as bond proceeds are spent. When new bonds are issued, the balance is replenished to about \$200 million.

The majority of revenues for the Grants Fund are reimbursement-based, which often results in the fund having a negative cash balance at the end of the fiscal year (as was the case from 2012 to 2017). In particular, the Department of Human Services experienced issues with filing and receiving reimbursements from the Commonwealth of Pennsylvania in a timely fashion in the past. These issues saw great improvement in FY18, contributing to the \$250 million increase from 2017 to 2018 in the Grants Fund cash balance. This is an important development because when the Grants Fund balance is negative, the General Fund and other funds within the Consolidated Cash account must loan funds to the Grants Fund to pay its obligations.



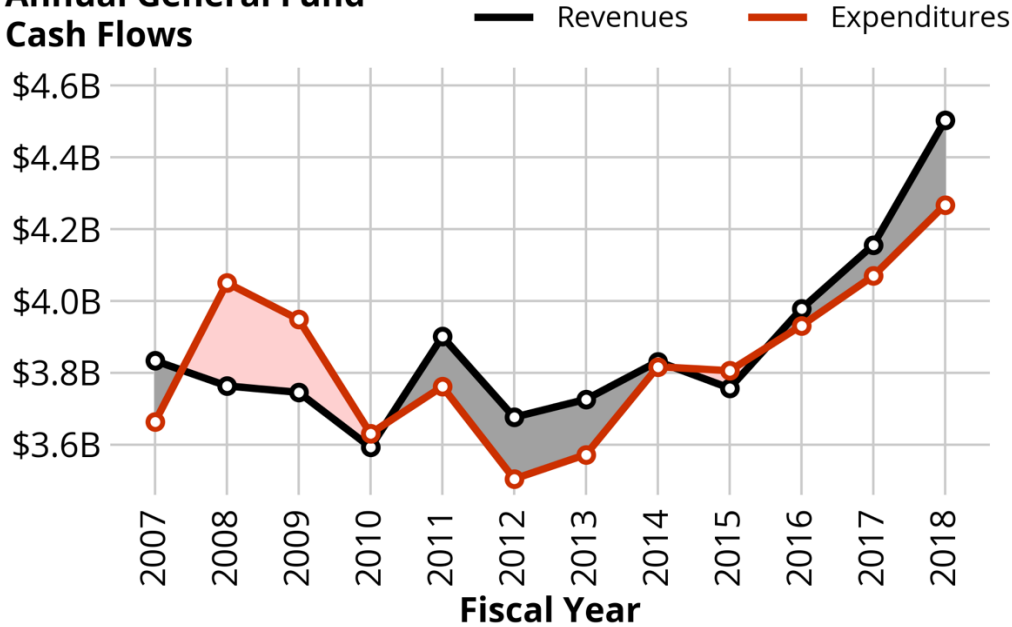
Another way to view the historical trends in the cash position of the City is through the year-over-year changes in the balances of the various funds. The strong growth in cash in FY18 brackets the City's recovery from the large cash losses experienced in 2008 due to the Great Recession. The year-over-year changes also show FY18 as the only year in the past decade with balance increases for each of the Grants, Capital, and General Funds, leading to an increase of more than \$600 million in the Consolidated Cash balance in a single year.

The General Fund

As the principal operating fund for the City, the General Fund's finances offer a unique perspective on the City's current fiscal state. Monthly revenues and expenditures for the General Fund are published as part of the QCMR and offer further insight into the cash position of the City. The majority of revenues for the General Fund are generated from local taxes, the largest of which are the Wage Tax, Real Estate Tax, and Business Income and Receipts Tax. On the expenditure side, the City's largest annual costs are due to payroll, pension payments, and employee benefits. Other costs include purchases of services (e.g. contracts), debt payments, and equipment and supplies.

Annual Cash Flows

Annual General Fund Cash Flows



The chart above shows the annual fiscal year totals for General Fund revenues (black) and expenditures (red).³ The relative difference between these totals determines if the General Fund cash balance increases or decreases from year to year. To help guide the reader, periods when the balance decreased are shaded red, while periods when the balance increased are shaded black. The immense impact of the Great Recession is again clear, with expenditures outpacing revenues by a significant margin from 2008 through 2010. It's important to note that in fiscal year 2012, the majority of Department of Human Services expenses and associated revenues were transferred from the General Fund to the Grants Fund, leading to a significant drop in both General Fund revenues and expenditures. The City's recovery in recent years has been driven by a sharp increase in annual revenue, which has grown by 20% since 2015.

The sharp rise in revenues in the last three years has been driven by a combination of increased taxation and the recovering economic health of the City. An improved economy has contributed to eight consecutive years of growth in Wage Tax revenue, while an improved real estate market has led to increased receipts from the Realty Transfer Tax (the tax on real estate sales or transfers). The last three years have also seen the addition of the Philadelphia Beverage Tax, as well as single-year increases to the tax rates for the Real Estate Tax and Realty Transfer Tax.⁴

Annual General Fund expenditures, which reached a low point in fiscal year 2012, have also increased in recent years, although less significantly than revenues. Over the last three years, expenses have increased by 12%, driven primarily by the City's rising fixed costs: pension costs

³ Note that General Fund revenues and expenditures refer to the "Total Cash Receipts" and "Total Disbursements" line items, respectively, in the Cash Flow Forecast of the QCMR.

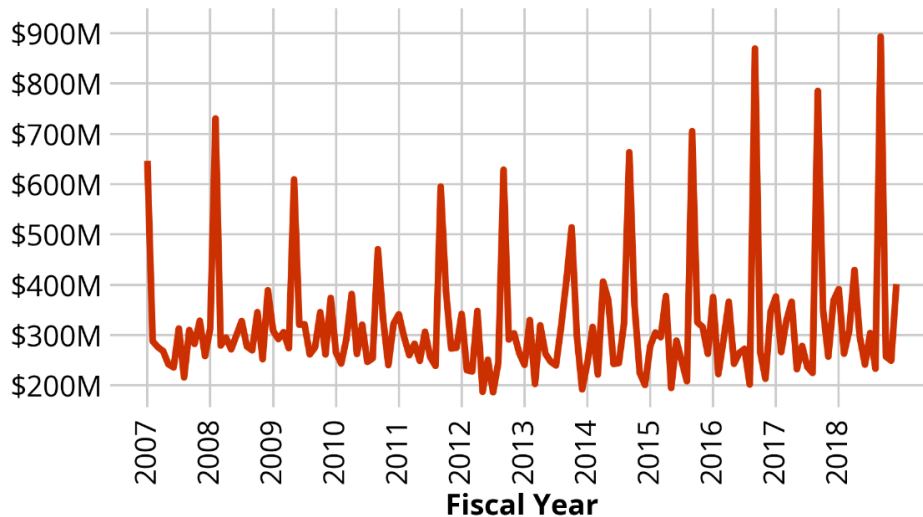
⁴ The past three fiscal years have also seen reductions to the tax rates for the Wage Tax and Business Income & Receipts Tax. In the case of the Wage Tax, the recovering economy has led to increases to the overall revenue that have outpaced losses from rate decreases.

alone increased by 16%, while debt service increased by 13%. Other increases have included payroll and employee benefits (8%) and contracted expenditures (9%).

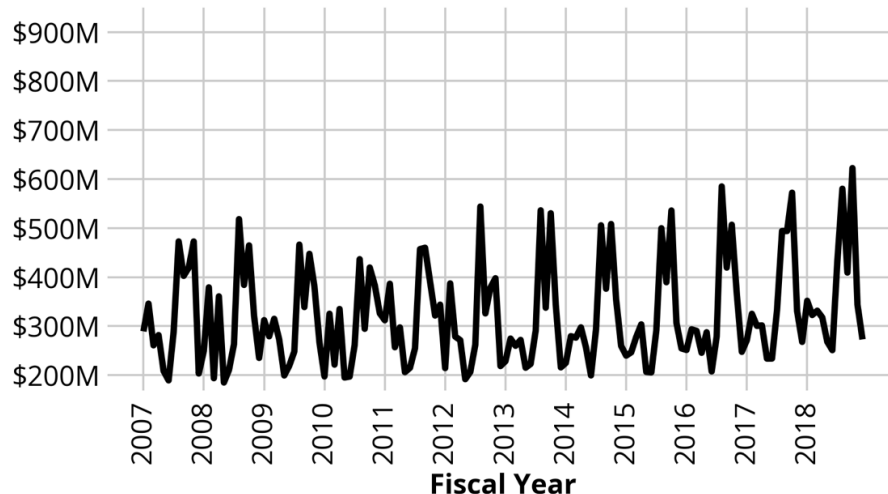
Monthly Cash Flows

The General Fund revenues and expenditures on a monthly basis provide a window into the fiscal challenges of the day-to-day operations of the City. As seen in the top panel of the chart below, monthly expenditures for the General Fund are typically at least \$200 million, but can vary significantly from month to month. In particular, the large spending spikes in the chart below are due to the City's pension payment, which is its single largest expense. Prior to fiscal year 2010, the payment was made each year in the fall, but has since been moved to the spring in order to better align with the timing of revenue receipts. Over the past decade, the City's pension costs have grown substantially, which is reflected in the growing size of the spikes in the chart below.

**Monthly General Fund
Cash Expenditures**



**Monthly General Fund
Cash Revenues**

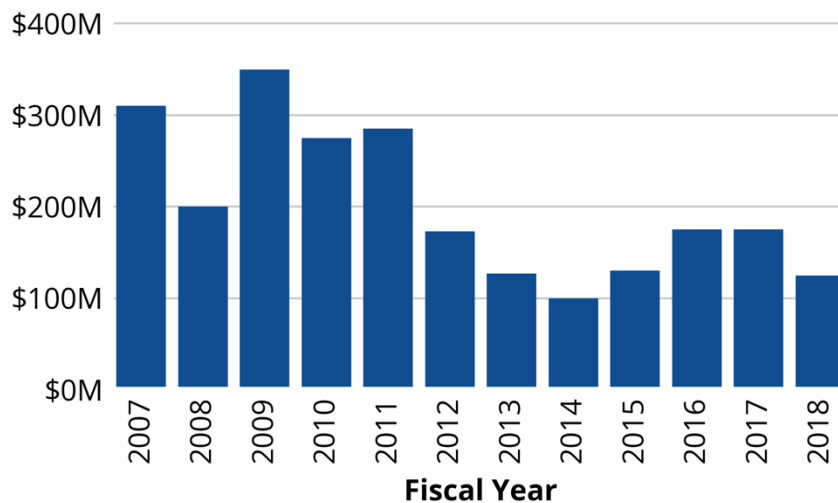


Monthly General Fund revenues also show seasonal trends, but to a lesser extent than expenditures. Revenue receipts have two particularly strong months, as seen in the lower panel of the above chart. The first spike occurs in February and is from Real Estate Tax receipts, while the second is in April due to receipts from the Business Income and Receipts Tax.

The seasonal trends in revenue receipts are not aligned with those of expenditures, leading to fluctuations in the cash balance from month to month. Like many other local governments, the timing of expenditures and revenues presents one of the main challenges of monthly operations. To relieve the seasonal trends in its cash flow, the City borrows short-term funds, known as Tax and Revenue Anticipation Notes (TRANs), which are paid back by the end of the fiscal year. The size of the TRANs issued each year provides an indicator of the cash position of the General Fund. With lower cash balances, the City must borrow more money to cover the monthly fluctuations in expenditures.

The chart below shows these annual short-term borrowing amounts for fiscal years dating back to 2007. The weak General Fund cash position in the years directly after the Great Recession is apparent—the City issued \$350 million, \$275 million, and \$285 million in fiscal years 2009, 2010, and 2011, respectively. For comparison, the TRAN amount for fiscal year 2018, with the strongest cash position of the past decade, was only \$125 million.

Short-term General Fund Borrowing Amounts



Summary

The fourth quarter of fiscal year 2018 ended a historically notable year for the City's cash balances. The balance of the Consolidated Cash account more than doubled in FY18, ending with a total of \$993 million. This large cash increase was driven by balance increases for each of the General, Capital, and Grants Funds - the first time this has occurred in the last ten years. A surplus of \$235 million in cash receipts over expenditures led to a fiscal year-end cash balance of \$769 million for the General Fund, the highest of the past decade. The General Fund cash

position has shown remarkable improvement since its low point following the Great Recession when it ended fiscal year 2010 with a deficit of \$31 million.

The City's cash position is an important measure of its financial health. Cash enables the City to perform the daily operations of a local government and pay its short-term obligations. In its recovery from the Great Recession, Philadelphia has struggled to meet fund balance recommendations for local governments.⁵ However, FY18 brought a significant increase to the City's cash position, and the closing General Fund balance of \$769 million represents 18% of its annual cash expenditures in FY18.

⁵ See the discussion of modified accrual vs cash basis in the introduction.